

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-125755-02

Date:

JULY 31, 2002

Re:

Legend:

Grantor =

Taxpayer =

Trust 1 =

Trust 2 =

Trust 3 =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

Date 2 =

Date 3 =

State =

State Statute =

Dear :

This is in reference to the letter dated April 23, 2002, from your authorized representative requesting a ruling regarding the effect of the proposed testamentary exercise of limited powers of appointment on the exempt status of trusts for federal estate tax and generation-skipping transfer (GST) tax purposes.

Grantor, a grandparent of Taxpayer, died in Year 3. During her lifetime, Grantor created Trusts 1 and 2, irrevocable inter vivos trusts. In addition, under the terms of her will, Trust 3 was established for the primary benefit of Taxpayer. Taxpayer's father is deceased. The trusts are governed by the laws of State.

Trust 1

Grantor established Trust 1 in Year 1. Under Paragraph 2 of Trust 1, after all proper expenses and charges are paid, the trustees have absolute discretion to distribute the remaining net income to or for the benefit of Taxpayer's father and his descendants in such amounts and at such times as the trustees deem advisable.

Paragraph 3 provides that Taxpayer is given a testamentary non-general power of appointment over the balance of Trust 1, which may be exercised in favor of the members then or thereafter living of a class composed of the Grantor's issue (except Taxpayer, Taxpayer's father, or their estates or the creditors of their estates), and of the spouses of such issue (including the spouse of Taxpayer), or any one or more of the members of such class, in such proportions and upon such lawful estates, trusts, terms and conditions as Taxpayer may direct or appoint by will.

In default of Taxpayer's exercise of the testamentary power to appoint the trust corpus, the corpus will pass pursuant to Paragraph 4 of Trust 1 to the then living issue of Taxpayer's father, per stirpes. If no such issue exist, then the trust corpus will pass to the persons, excluding Grantor, who would then be entitled thereto under the laws of State, if Taxpayer had died the owner thereof intestate and a resident of State.

Under Paragraph 6(y), neither Taxpayer, any other income beneficiary, nor the spouse of any income beneficiary who becomes a trustee shall participate in any decision regarding the distribution of income to a beneficiary.

Trust 2

Grantor established Trust 2 in Year 2. Under Paragraph 2 of Trust 2, after all proper expenses and charges are paid, the trustees have absolute discretion to distribute the remaining net income to or for the benefit of Taxpayer, his spouse, his descendants, and the spouses of his descendants in such amounts and at such times as the trustees deem advisable.

Paragraph 3 provides that Taxpayer is given a testamentary non-general power of appointment over the balance of Trust 2, which may be exercised in favor of the members then or thereafter living of a class composed of the Grantor's issue (except Taxpayer, his estate or the creditors of his estate), and of the spouses of such issue (including the spouse of Taxpayer), or any one or more of the members of such class, in such proportions and upon such lawful estates, trusts, terms and conditions as Taxpayer may direct or appoint by will.

In default of Taxpayer's exercise of the testamentary power to appoint the trust corpus, the corpus will pass pursuant to Paragraph 4 of Trust 2 to the then living issue of Taxpayer, per stirpes. If no such issue exist, then the trust corpus will pass to the persons, excluding Grantor,

who would then be entitled thereto under the laws of State, if Taxpayer had died the owner thereof intestate and a resident of State.

Under Paragraph 6(y), neither Taxpayer, any other income beneficiary, nor the spouse of any income beneficiary who becomes a trustee shall participate in any decision regarding the distribution of income to a beneficiary.

Trust 3

Trust 3 is a testamentary trust that was established under Item 5 of Grantor's will. Item 5(a) of the will provides that the trustees have absolute discretion to invest or reinvest the assets of Trust 3 and to divide and distribute the net income to or for the benefit of Taxpayer, his spouse, his issue and the spouses of his issue, or some one or more of the members of such class in such amounts and at such times as the trustees deem advisable. Item 5(b) provides that the trustees may also in their absolute discretion at one time, or from time to time, in the event of possible emergencies such as serious accident or illness or other event, upon the happening of which his immediate necessities will outweigh considerations of permanency of income, pay to or for the benefit of Taxpayer, free of trusts, such part of the principal of Trust 3. Any such payment or application of principal shall be charged against the principal of such fund in such manner as the trustees may determine.

Pursuant to Trust 3, Item 5(c), upon the death of Taxpayer, Trust 3 shall be distributed to, or for the benefit of, any one or more of the members then or thereafter living, (a) of a "narrow" familial class composed of Taxpayer's spouse and his issue, and the spouses of such issue, or (b) if none of his issue shall survive Taxpayer, then of a "broader" familial class composed of Grantor's issue and the spouses of such issue, to whom Taxpayer may appoint, in such proportions, and either outright or upon such lawful estates, trusts, terms and conditions, and subject to such lawful powers as Taxpayer may direct or appoint by will. In default of Taxpayer's exercise of the testamentary power to appoint the trust corpus, the balance of the trust fund will pass to Taxpayer's issue, then living, per stirpes. If no such issue exist, then to the persons, excluding Grantor, who would then be entitled thereto under the laws of State, if Taxpayer had died the owner thereof intestate and a resident of State.

Under Item 8(x), no eligible income beneficiary nor the spouse of such eligible income beneficiary who becomes trustee can participate in any determination regarding the distribution of principal or income to a beneficiary.

Under State Statute, a nonvested property interest is invalid unless, when the interest is created, (1) it is certain to vest or terminate no later than twenty-one years after the death of an individual then alive, or (2) the interest either vests or terminates within ninety years after its creation. In addition, under State Statute, a nongeneral power of appointment is invalid unless, when the power is created, (1) it is certain to be irrevocably exercised or to terminate no later than twenty-one years after the death of an individual then alive, or (2) the power is irrevocably exercised or terminates within ninety years after its creation.

Proposed Transaction

Taxpayer proposes to execute a will in which he will exercise his testamentary powers of appointment over Trusts 1, 2 and 3. Taxpayer will appoint all of the property included in Trusts

1, 2, and 3 at the time of Taxpayer's death that is subject to and capable of being appointed by Taxpayer's exercise of each and all of such powers of appointment, to Taxpayer's trustees, each to be held, in separate trust as follows:

(1) The property constituting Trust 1 shall be held in a separate trust to be known as "Taxpayer Family Trust No. 1";

(2) The property constituting Trust 2 shall be held in a separate trust to be known as "Taxpayer Family Trust No. 2";

(3) The property constituting Trust 3 shall be held in a separate trust to be known as "Taxpayer Family Trust No. 3."

These trusts will collectively be referred to as the "Taxpayer Family Trusts."

Under the proposed terms of Taxpayer's will, each of Taxpayer's Family Trusts are to be administered as separate single trusts during the lifetime of Taxpayer's spouse, provided she survives Taxpayer. The trustees will have discretion to pay to or apply for the benefit of Taxpayer's spouse, Taxpayer's children and the living descendants of any deceased child or children of Taxpayer (regardless of whether such deceased child or children survived Taxpayer) so much or all of the net income and principal from the Taxpayer Family Trusts as the trustees determine is necessary and advisable for their health, support, maintenance and education. Any payments of principal made to or for the benefit of a child or a descendant of Taxpayer pursuant to this provision will be charged against the ultimate distributive share of the child or descendant to whom or for whose benefit the payments are made.

Upon the death of Taxpayer's spouse (or upon Taxpayer's death, in the event Taxpayer's spouse predeceases Taxpayer), the trust estate of each Taxpayer Family Trust is to be divided into separate trusts so as to provide one separate trust for each then living child of Taxpayer and one separate trust for each predeceased child of Taxpayer who has descendants then living. Each trust set aside for a predeceased child of Taxpayer who leaves descendants then living will be further divided into separate shares within said separate trust, per stirpes, among the descendants of such predeceased child of Taxpayer.

Until the beneficiary reaches age 21, the trustees may distribute the net income and principal from each separate trust or trust share for the health, support, maintenance and education of the beneficiary. Any undistributed income is to be accumulated and added to principal at the end of each year. At age 21 and thereafter, during the beneficiary's lifetime, (or until termination of the trust or trust share, as the case may be), the entire net income of the separate trust or share is to be paid to the beneficiary at convenient intervals, not less frequently than annually. Whenever in the opinion of the trustees, the net income of the trust estate is insufficient for the proper health, support, maintenance and education of such beneficiary, the trustees will have discretion to distribute principal to or for the benefit of such beneficiary's health, support, maintenance and education.

Upon the death of a beneficiary, the undistributed balance of the trust or trust share being administered for the benefit of such beneficiary, if any, shall be paid over, conveyed, and distributed outright to or among, or in trust for the benefit of, any of Taxpayer's then living descendants, and no other persons, in such a manner and in such proportions as such

deceased beneficiary may appoint in and by his or her last will. However, any trust created by exercise of the power of appointment granted by Taxpayer to a beneficiary must terminate and the entire trust estate be distributed free of trust no later than: in the case of Taxpayer Family Trust 1, Date 1; in the case of Taxpayer Family Trust 2, Date 2; and in the case of Taxpayer Family Trust 3, Date 3. The balance of each trust share within each Taxpayer Family Trust in existence shall, at such time, be distributed outright and free of trust to the then living income beneficiary of such share.

In default of the exercise of this power of appointment by the beneficiary, or insofar as any part of such share shall not be effectively appointed, then upon the death of such deceased beneficiary, the undistributed balance of such deceased beneficiary's trust estate, or the part of such trust estate not effectively appointed, shall be divided per stirpes into separate shares for each of such beneficiary's then living descendants. If no such descendants exist, the trust corpus is to be divided per stirpes into separate shares for each of the then living descendants of the parent of such deceased beneficiary who was either Taxpayer or one of Taxpayer's descendants; or in default thereof, then per stirpes into separate shares for each of Taxpayer's then living descendants, or in default of any such living descendants, to said deceased beneficiary's estate.

Finally, each trust created under the terms of the will, if not terminated earlier, must terminate on the following dates: Family Trust 1 shall terminate on Date 1; Family Trust 2 shall terminate on Date 2; and Family Trust 3 shall terminate on Date 3.

You have requested the following rulings:

1. The testamentary exercise by Taxpayer of the powers of appointment over Trusts 1, 2, and 3 as proposed will not result in any property subject to the powers being includible in the Taxpayer's gross estate under § 2041 of the Internal Revenue Code.
2. The proposed exercise of the power of appointment by Taxpayer over Trusts 1, 2, and 3 will not result in a transfer of property that is subject to the generation-skipping transfer tax.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent possessed a general power of appointment at the time of death.

Section 2041(a)(3) provides that the value of the gross estate includes the value of all property to the extent of any property with respect to which the decedent by will exercises a power of appointment created after October 21, 1942, by creating another power of appointment which, under the applicable local law, can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

Section 2041(b)(1) defines the term "general power of appointment" as a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate. A power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides that a power of appointment is not a general power if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or (b) expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate, or the creditors of his estate.

Under § 20.2041-1(c)(2), a power is limited by an ascertainable standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). The words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life.

Section 20.2041-3(e)(1) provides, in part, that property subject to a power of appointment created after October 21, 1942, which is not a general power, is includible in the holder's gross estate if the power is exercised by will and if the power is exercised by creating another power of appointment which, under the terms of the instrument creating and exercising the first power and under applicable local law, can be validly exercised so as to: (a) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of creation of the first power, or (b) (if the applicable rule against perpetuities is stated in the terms of suspension of ownership or of the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

Section 2601 imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act), 1986-3(Vol. 1) C.B. 1, and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer was not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). Section 26.2601-1(b)(1)(ii) provides that any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in settlor's gross estate under §§ 2038 or 2042 if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

Section 26.2601-1(b)(1)(v)(B) provides a special rule for certain powers of appointment. Under this section, the release, exercise, or lapse of a power of appointment (other than a

general power of appointment as defined in § 2041(b)) will not be treated as an addition to a trust if (1) such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under § 26.2601-1(b)(1); and (2) in the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of § 26.2601-1(b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. This section also provides that if a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Section 26.2601-1(b)(1)(v)(D), Example 6, describes a situation where prior to the effective date of chapter 13, GP established an irrevocable trust under which the trust income was to be paid to GP's child, C, for life. C was given a testamentary power to appoint the remainder in further trust for the benefit of C's issue. In default of C's exercise of the power, the remainder was to pass to charity. C died on February 3, 1995, survived by a child who was alive when GP established the trust. C exercised the power in a manner that validly extends the trust in favor of C's issue until the later of May 15, 2064 (80 years from the date the trust was created), or the death of C's child plus 21 years. C's exercise of the power is a constructive addition to the trust because the exercise may extend the trust for a period longer than the permissible periods of either the life of C's child (a life in being at the creation of the trust) plus 21 years or a term not more than 90 years measured from the creation of the trust. On the other hand, if C's exercise of the power could extend the trust based only on the life of C's child plus 21 years or only for a term of 80 years from the creation of the trust (but not the later of the two periods) then the exercise of the power would not have been a constructive addition to the trust.

In Example 7 of § 26.2601-1(b)(1)(v)(D), the facts are the same as in Example 6, except that local law provides that the effect of C's exercise is to extend the term of the trust until May 15, 2064, whether or not C's child predeceases that date by more than 21 years. C's exercise is not a constructive addition to the trust because C exercised the power in a manner that cannot postpone or suspend vesting, absolute ownership, or power of alienation for a term of years that will exceed 90 years. The result would be the same if the effect of C's exercise is either to extend the term of the trust until 21 years after the death of C's child or to extend the term of the trust until the first to occur of May 15, 2064 or 21 years after the death of C's child.

In the present case, under the terms of Paragraph 3 of Trust 1, Taxpayer's testamentary power of appointment over the trust corpus can only be exercised in favor of a class consisting of the spouse of Taxpayer, the lineal descendants of Taxpayer, and the spouses of such lineal descendants. Likewise, under the terms of Trust 2, Paragraph 3 and Trust 3, Item 5(c), Taxpayer's testamentary power over the corpus may only be exercised in favor of the spouse of Taxpayer, the lineal descendants of Taxpayer, and the spouses of such lineal descendants. (Under Trust 3, if Taxpayer is not survived by issue, the power may be exercised in favor of Grantor's issue "thereafter living.") Since Taxpayer cannot appoint to himself, his creditors, his estate, or the creditors of his estate, Taxpayer's testamentary powers to appoint created under

Paragraph 3 of Trust 1, Paragraph 3 of Trust 2, and Item 5(c) of Trust 3 are not testamentary general powers of appointment. Accordingly, the exercise of such power as proposed will not result in the value of either Trust 1, 2, or 3 being included in the Taxpayer's gross estate under § 2041(a)(2).

Trusts 1 and 2 were established as irrevocable trusts in Year 1 and Year 2, respectively. Trust 3, a residual testamentary trust, was established upon the Grantor's death in Year 3. The Taxpayer proposes to exercise the nongeneral powers of appointment created in Paragraph 3 of Trust 1, Paragraph 3 of Trust 2, and Item 5(c) of Trust 3 in favor of Taxpayer Family Trusts 1, 2, and 3, respectively. The terms of the Taxpayer Family Trusts provide that each trust, and any trust created under the terms of the trust must terminate no later than a date which is less than 88 years from the date of the creation of the respective powers of appointment granted to Taxpayer under Trusts 1, 2, and 3. Taxpayer Family Trust 1 will terminate no later than Date 1. Taxpayer Family Trust 2 will terminate no later than Date 2. Taxpayer Family Trust 3 will terminate no later than Date 3. The balance of each trust share in existence shall, at such time, be distributed outright and free of trust to the then living income beneficiary of such share.

Under the terms of the Taxpayer Family Trusts, the trust property will be distributed outright and free of trust, in all events, within a period measurable from the date of creation of the original powers. Thus, the proposed testamentary exercise of the powers will not create other powers that may be exercised in a manner that postpones the vesting or absolute ownership of any property interest without regard to the date of the creation of the original powers in each of the three trusts.

Consequently, the proposed testamentary exercise of the powers of appointment by the Taxpayer will not result in the value of Trusts 1, 2, or 3 being included in Taxpayer's gross estate under § 2041(a)(3).

All three trusts over which Taxpayer has a testamentary nongeneral power of appointment were irrevocable on September 25, 1985.

As described above, Taxpayer Family Trusts 1, 2, and 3 (including any trusts created under the terms of the trust instruments) must terminate no later than 88 years from the date of the creation of Trusts 1, 2, and 3, respectively. Hence, Taxpayer's proposed testamentary exercise of the nongeneral powers under Paragraph 3 of Trust 1, Paragraph 3 of Trust 2, and Item 5(c) of Trust 3 in favor of Taxpayer Family Trusts will not postpone or suspend the vesting, absolute ownership or power of alienation of any interest in trust property for a period beyond a date which is 90 years measured from the date of creation of Trusts 1, 2, or 3.

Consequently, Taxpayer's proposed testamentary exercise of the nongeneral powers under Paragraph 3 of Trust 1, Paragraph 3 of Trust 2, and Item 5(c) of Trust 3 in favor of Taxpayer Family Trusts will not be constructive additions that will be subject to the generation-skipping transfer tax. See § 26.2601-1(b)(1)(v)(B); § 26.2601-1(b)(1)(v)(D), Example 7.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for the rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

The ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

George L. Masnik
Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes

cc: